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FIRST NATIONAL STORES



ANNUAL REPORT

FOR THE YEAR ENDING MARCH 26, 1966

FIRST NATIONAL STORES INC.

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JOHN L. MACNEIL
EDMUND J. MURPHY
ADRIAN O'KEEFFE

TO THE STOCKHOLDERS OF FIRST NATIONAL STORES INC.:

Somerville, Massachusetts, June 1, 1966

Intense competition and lower profit margins were major factors in our reduced sales and earnings in fiscal 1966. There follows a summary of the results for the year.

Sales for the year ended March 26, 1966 amounted to \$684,492,243 compared with \$706,669,843 in the prior year, a decrease of 3.1%.

Net earnings were \$2,384,842, or \$1.45 a share. Earnings for the preceding year, before a special credit of \$888,390, or \$.54 a share on liquidation of subsidiaries, were \$5,560,030 or \$3.39 a share.

Dividends totaled \$2.50 per share, the same amount that was declared in the previous year, and consisted of four quarterly dividends of 50 cents a share and a year-end special dividend of 50 cents. Despite the decline in earnings in the past year, the Board of Directors declared the same dividends as in the prior year because of the strong financial condition of the Company.

Highlights:

	For the Year Ended	
	March 26, 1966	March 27, 1965
Retail store sales	\$684,492,243	\$706,669,843
Net operating earnings	\$ 2,384,842	\$ 5,560,030
Per share of common stock—		
After taxes and before Lifo adjustment	\$1.74	\$3.40
Lifo inventory adjustment	— .29	— .01
Total	<u>\$1.45</u>	<u>\$3.39</u>
Net working capital (current assets less current liabilities)	\$ 36,554,505	\$ 34,964,630
Fixed or property assets (less depreciation)	\$ 59,000,525	\$ 62,916,166
Stockholders' equity (net worth)	\$ 95,928,104	\$ 97,906,943

Results of our operations for prior years are shown on subsequent pages.

Working capital on March 26, 1966 totaled \$36,554,505 as against \$34,964,630 at the close of last year. Current assets amounted to \$60,496,329 compared with current liabilities of \$23,941,824 or a ratio of 2.53 to 1 which compares favorably with the 2.40 ratio in 1965. Net capital expenditures for the year were \$6,293,809. Long-term debt at year-end was \$6,131,000, a reduction of \$534,000.

At the close of the year the Company was operating five hundred and seventy-three stores, four hundred and ninety of which were supermarkets. Thirteen new stores were opened and forty unprofitable or outmoded stores were closed during the year. Among those closed were twenty-nine supermarkets and eleven small, self-service grocery stores. Extensive remodeling or enlargement occurred in twenty-seven stores.

In the past year, significant changes were experienced in the retail food industry in our operating area. Merchandising programs, featuring severe price reductions accompanied by the discontinuance of trading stamps, had already been initiated by some competitors at the start of our fiscal year. These programs were greatly expanded during the year and were adopted by some of the larger regional chains. Our Company and retailers in general in our operating territory responded with increased promotional activity, including sharp price reductions which resulted in a substantial lowering of profit margins. At the same time there was a large increase in the number of competitive stores opened.

In addition to the effects of lower sales and profit margins, earnings were reduced by high promotional expense and the Lifo method of inventory valuation. The sharp rise in the wholesale prices of meats and groceries during the period resulted in an unusually large Lifo inventory adjustment charge against earnings. The Lifo adjustment, after tax, amounted to \$476,495 or 29 cents per share as against 1 cent per share in the prior year. The Lifo method of accounting has been used by the Company since 1942 and results in a charge against earnings when wholesale prices rise and a credit when they decline. It has proved beneficial through the years.

While the majority of our stores are successful, a smaller group with substantial losses has had a disproportionate effect on over-all results. Accordingly, management has initiated an accelerated program of closing unprofitable stores which seem to be lacking potential for the future. This project, begun during the past year, will be continued and expanded in the current year.

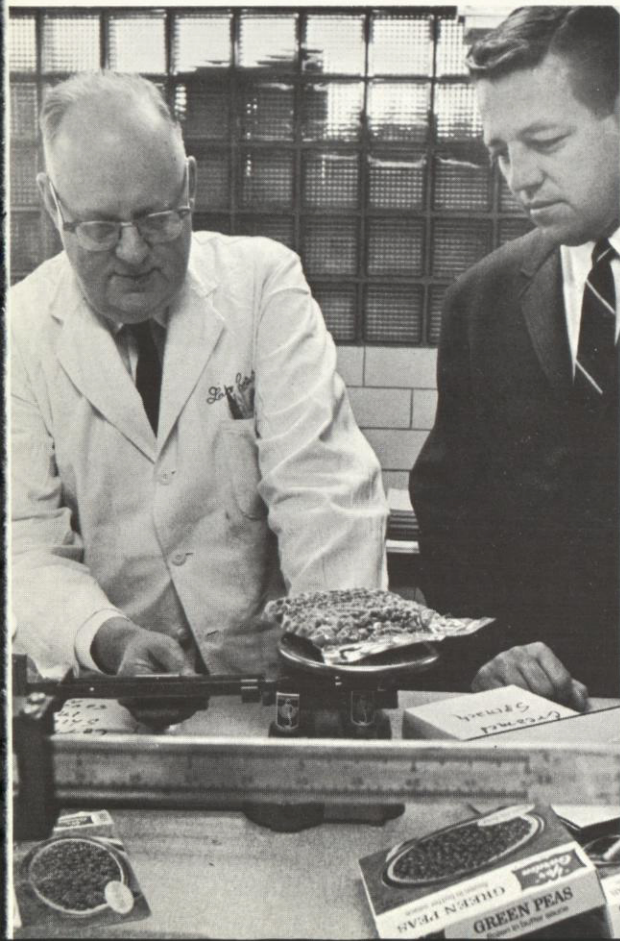
The closing or disposition of these stores may result in special charges. However, since most of the stores we plan to close have been incurring losses, the Company will be in a better position when they are eliminated. Any net losses involved will be charged to an existing reserve which we consider adequate for the purpose.

Our manufacturing facilities enable us to provide our customers with many fine quality foods which represent extra value. This line of products includes bakery goods of all kinds, coffee, tea, jams and jellies, frankforts, luncheon meats, spices, salad dressings and carbonated beverages, among many others. During the year our own label appeared on several new and profitable lines. The quality of these new items is excellent and they have been well received by consumers.

There will be an increase in the number of new stores in the current year, with approximately twenty-five units scheduled for opening. We also plan extensive remodeling in our program of keeping our retail facilities modern and attractive. Our supermarkets generally compare favorably with the best in the industry.

Although we see no immediate lessening of the competitive pace in our marketing areas, we are confident that our loyal and able organization will prove equal to the task ahead.

ADRIAN O'KEEFE
President



Training, research and education play important parts in the conduct of our day-to-day activities, whether in the improvement of customer contact at the checkout, development of new products and packages, or instruction to farm and school youth.

Photos on this page show, at top, a shopping center supermarket in Portland, Maine. Left and right above; on-the-job checker training and 4-H boys and girls during a warehouse visit. Bottom, quality control in our laboratory and a meat cutting demonstration for a home economics class in one of our store cutting rooms.



FIRST NATIONAL STORES INC.

FIFTEEN-YEAR REVIEW (IN THOUSANDS OF DOLLARS EXCEPT FOR PER SHARE AMOUNTS)

	1966	1965	1964	1963	1962	1961
RESULTS OF OPERATIONS						
Retail store sales	\$ 684,492	\$ 706,670	\$ 723,402	\$ 746,089	\$ 711,304	\$ 536,486
Net earnings	2,385	5,560	7,103	7,788	8,172	7,859
Net earnings per share	1.45	3.39	4.33	4.73	4.98	4.80
Cash dividends per share	2.50	2.50	2.50	2.50	2.50	2.50
FINANCIAL POSITION						
Current assets	60,496	59,985	61,502	65,466	68,802	52,100
Current liabilities	23,942	25,020	31,604	36,663	46,017	29,997
Net working capital	36,554	34,965	29,898	28,803	22,785	22,103
Ratio of current assets to current liabilities	2.53	2.40	1.95	1.79	1.50	1.74
Fixed assets, net	59,001	62,916	66,259	66,312	68,138	58,061
Total assets	126,001	129,592	134,907	138,994	145,596	115,040
Long term debt	6,131	6,665	7,733	9,750	10,250	—
Stockholders' equity	95,928	97,907	95,570	92,581	89,329	85,043
OTHER DATA						
Capital expenditures — net	6,294	7,669	11,341	9,967	20,982	9,767
Provision for depreciation	10,467	11,367	11,606	12,354	10,533	9,517
Shares of common stock outstanding (at end of year)	1,631,404	1,638,904	1,639,204	1,639,598	1,647,670	1,637,154
Number of stores (at end of year)	573	600	601	610	632	516

1960	1959	1958	1957	1956	1955	1954	1953	1952
\$ 525,351	\$ 531,521	\$ 521,495	\$ 507,631	\$ 491,668	\$ 470,629	\$ 442,180	\$ 424,522	\$ 406,773
8,223	8,649	8,799	8,039	8,071	7,969	6,831	6,742	5,571
5.02	5.28	5.37	4.91	4.93	4.86	4.17	4.11	3.40
2.50	2.50	2.50	2.50	2.40	2.40	2.25	2.00	1.87½
44,737	43,665	45,728	47,013	42,576	42,156	38,943	38,487	36,296
24,226	25,258	28,202	27,418	27,426	26,820	25,294	26,097	25,923
20,511	18,407	17,526	19,595	15,150	15,336	13,649	12,390	10,373
1.85	1.73	1.62	1.71	1.55	1.57	1.54	1.47	1.40
57,172	55,411	52,579	46,340	39,728	35,932	33,710	31,878	31,846
105,503	102,405	101,210	95,892	88,046	83,484	78,037	75,754	73,444
—	—	—	—	—	—	—	—	—
81,277	77,147	72,590	67,884	59,872	55,730	51,690	48,543	46,341
11,239	11,636	14,763	13,986	10,130	8,073	7,560	5,103	5,546
9,411	8,912	8,175	6,821	5,921	5,410	4,734	4,334	4,257
1,637,154	1,637,154	1,637,154	1,637,154	1,637,154	1,637,154	1,637,154	1,637,154	1,637,154
534	543	575	607	661	702	761	847	922

FIRST NATIONAL STORES INC.

BALANCE SHEET

ASSETS

	MARCH 26 1966	MARCH 27 1965
Current assets:		
Cash	\$ 18,909,328	\$ 19,827,467
Accounts receivable	4,608,703	3,898,944
Inventories, on last-in, first-out cost basis, which is below market	36,978,298	36,258,643
Total current assets	<u>\$ 60,496,329</u>	<u>\$ 59,985,054</u>
Fixed assets, at cost (excluding fully-depreciated assets):		
Land	\$ 8,024,819	\$ 8,009,555
Buildings owned	35,044,083	35,023,382
Store fixtures, leased property improvements, machinery and equipment	90,915,604	90,244,441
Automotive equipment	7,254,427	6,926,919
	<u>\$141,238,933</u>	<u>\$140,204,297</u>
Less — Depreciation	82,238,408	77,288,131
	<u>\$ 59,000,525</u>	<u>\$ 62,916,166</u>
Other assets and deferred charges:		
Investment in and advances to wholly-owned subsidiary companies, at cost (represented by underlying net assets of \$208,851 in 1966, \$140,653 in 1965)	\$ 110,000	\$ 60,500
Prepaid insurance and other deferred expenses	5,360,350	5,445,975
Miscellaneous	1,033,724	1,184,672
	<u>\$ 6,504,074</u>	<u>\$ 6,691,147</u>
	<u>\$126,000,928</u>	<u>\$129,592,367</u>

NOTES TO FINANCIAL STATEMENTS

NOTE 1: As of March 27, 1965 options to purchase 36,700 shares of the company's common stock were held by certain officers and key employees of the company and its subsidiaries. During the year, options for 3,000 shares terminated. At March 26, 1966 options for 33,700 shares were outstanding at prices ranging from \$54.86 to \$64.25 per share, of which options for 33,400 shares were then exercisable. The options become exercisable in equal annual instalments over a four-year period beginning one year after the date granted. Under the terms of the plan as amended, additional options for 41,300 shares may be granted at prices no less than 100% of the fair market value of the common stock at the date of grant. Such options expire not more than five years after the date granted.

NOTE 2: In the loan agreement covering the 4.70% notes there are restrictions on the payment of cash dividends and the acquisition of the company's common stock. At March 26, 1966 the portion of earnings employed in the business available for such payments and acquisitions was approximately \$19,250,000.

NOTE 3: At March 26, 1966 the company had commitments under 541 leases covering stores and warehouses. Minimum annual rental commitments under these leases, exclusive of taxes and other expenses and, in some cases, additional rentals based on percentage of sales, amount to approximately \$12,500,000. Of the aggregate annual rental commitment, \$11,700,000 applies to leases expiring prior to April 1, 1983 and most of the remainder to leases expiring thereafter but prior to 1987.

FIRST NATIONAL STORES INC.

BALANCE SHEET

LIABILITIES

	MARCH 26 1966	MARCH 27 1965
Current liabilities:		
Accounts payable	\$ 15,480,318	\$ 14,089,107
Accrued expenses	7,720,964	8,211,325
Current portion of long-term debt	267,000	267,000
Federal income taxes	473,542	2,452,992
Total current liabilities	<u>\$ 23,941,824</u>	<u>\$ 25,020,424</u>
4.70% Notes, due in equal semiannual instalments, 1967 to 1978	<u>\$ 6,131,000</u>	<u>\$ 6,665,000</u>
Stockholders' equity:		
Common stock, without par value (Note 1):		
Authorized — 2,000,000 shares		
Issued — 1,655,268 shares	\$ 31,977,422	\$ 31,977,422
Earnings employed in the business (Note 2)	65,026,650	66,728,368
	<u>\$ 97,004,072</u>	<u>\$ 98,705,790</u>
Less — Issued common stock held in treasury — 23,864 shares in 1966, 16,364 shares in 1965, at cost	1,075,968	798,847
Total stockholders' equity	<u>\$ 95,928,104</u>	<u>\$ 97,906,943</u>
Lease commitments (Note 3)		
	<u>\$126,000,928</u>	<u>\$129,592,367</u>

STATEMENT OF SOURCE AND USE OF FUNDS
YEAR ENDED MARCH 26, 1966

Source of funds:	
Net earnings	\$ 2,384,842
Depreciation of fixed assets	10,467,294
	<u>\$12,852,136</u>
Use of funds:	
Net additions to fixed assets	\$ 6,293,809
Cash dividends paid	4,086,560
Reduction in long-term debt	534,000
Acquisitions of treasury stock	277,121
Miscellaneous, net	70,771
Increase in working capital	1,589,875
	<u>\$12,852,136</u>

FIRST NATIONAL STORES INC.

STATEMENT OF EARNINGS

	YEAR ENDED	
	MARCH 26, 1966	MARCH 27, 1965
Income:		
Retail store sales	\$684,492,243	\$706,669,843
Dividends received from wholly-owned subsidiary companies (net earnings for the year — \$23,698 in 1966, \$37,083 in 1965)	5,000	5,000
Net gain on disposal of fixed assets	257,844	355,016
Other income	469,106	274,992
	<u>\$685,224,193</u>	<u>\$707,304,851</u>
Costs and expenses:		
Cost of sales, expenses, etc., exclusive of depreciation	\$671,503,822	\$686,263,472
Provision for depreciation of fixed assets	10,467,294	11,367,085
Interest expense	328,235	374,264
Provision for federal income taxes	540,000	3,740,000
	<u>\$682,839,351</u>	<u>\$701,744,821</u>
Net earnings	\$ 2,384,842	\$ 5,560,030
Special credit — Gain on liquidation of unconsolidated wholly-owned subsidiary companies		
	—	888,390
Net earnings and special credit	<u>\$ 2,384,842</u>	<u>\$ 6,448,420</u>

STATEMENT OF EARNINGS EMPLOYED IN THE BUSINESS YEAR ENDED MARCH 26, 1966

Balance, March 27, 1965	\$ 66,728,368
Net earnings	2,384,842
	<u>\$ 69,113,210</u>
Cash dividends paid — \$2.50 per share	4,086,560
Balance, March 26, 1966	<u>\$ 65,026,650</u>

OPINION OF INDEPENDENT ACCOUNTANTS

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS OF FIRST NATIONAL STORES INC.

In our opinion, the accompanying balance sheet, the statements of earnings and earnings employed in the business and the statement of source and use of funds present fairly the financial position of First National Stores Inc. at March 26, 1966 and the results of its operations and the supplementary information on funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Our examination of these statements was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Boston, Massachusetts
May 13, 1966

PRICE WATERHOUSE & CO.

Geographical Distribution
of
573 FIRST NATIONAL STORES



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